

## Message Text

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FM AMEMBASSY LISBON  
TO SECSTATE WASHDC IMMEDIATE 6315

C O N F I D E N T I A L SECTION 1 OF 3 LISBON 5194

E.O. 11652: GDS  
TAGS: ECON EFIN PO  
SUBJECT: ECONOMIC STUDY OF PORTUGAL

REF: (A) STATE 173068 (B) LISBON 3881 (C) LISBON 4303  
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FOLLOWING ARE EMBASSY COMMENTS ON ISSUES POSED REFTEL.

1. ECONOMIC SITUATION OVER THE MEDIUM TERM: GOP MUST GIVE  
PRIORITY TO A STABILIZATION PROGRAM FOR THE  
NEXT TWO TO THREE YEARS. PRINCIPAL OBJECTIVE OF THESE  
POLICIES IS TO REDUCE SHARPLY THE INEFFICIENT USE OF LIMITED  
BUDGET/CREDIT RESOURCES AND TO DAMPEN UNREALISTIC CONSUMER  
EXPECTATIONS. WITHOUT A SUCCESSFUL STABILIZATION PROGRAM,  
PORTUGAL WILL LACK REQUIRED FINANCIAL RESOURCES TO TRANSFORM  
ITS ECONOMY. YET THE COUNTRY'S OUTDATED PRODUCTION,  
DISTRIBUTION, AND ADMINISTRATIVE SYSTEMS MUST CHANGE IF THEY  
ARE TO RESOLVE THE POST-1974 REVOLUTION PROBLEMS OF HIGH  
UNEMPLOYMENT, A WEAK INTERNATIONAL MARKET, THE LOSS OF THE  
COLONIES, AND A LARGE EXTERNAL DISEQUILIBRIUM. THE  
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MODERNIZATION OF THESE SYSTEMS WILL NECESSITATE CONSIDERABLE  
FOREIGN EXCHANGE EXPENDITURES FOR, AMONG OTHER THINGS,  
VOLUMINOUS IMPORTS OF MACHINERY, INTERMEDIATE GOODS, AND  
RAW MATERIALS. THE NATION'S LARGE BALANCE OF PAYMENTS  
DEFICIT IS ALREADY ONE OF THE SEVEREST CONSTRAINTS ON THE  
NEEDED RESTRUCTURING PROCESS. A WEAKENING OF THE  
STABILIZATION PROGRAM TO PERMIT AN INCREASE IN, OR EVEN A

CONTINUANCE OF, PRESENT PER CAPITA CONSUMPTION LEVELS WOULD AGGRAVATE THE BALANCE OF PAYMENTS CONSTRAINT AND VERY LIKELY COMPROMISE SOUND LONG-TERM ECONOMIC RECOVERY.

UNLESS PORTUGAL FINDS A MEANS TO EASE THE EXTERNAL CONSTRAINT, ITS GNP IS LIKEY TO INCREASE LITTLE DURING THE FORESEEABLE FUTURE. INDEED, IF PORTUGAL WERE FORCED TO LIVE WITHIN ITS OWN FINANCIAL RESOURCE LIMITATIONS, ITS GNP WOULD LIKELY DECLINE IN THE SHORT TERM, DISPOSABLE INCOME WOULD FALL SHARPLY, INFLATION WOULD PERSIST AT THE DOUBLE DIGIT LEVEL, AND UNEMPLOYMENT WOULD RISE SIGNIFICANTLY, ALL WITH UNACCEPTABLE POLITICAL CONSEQUENCES (REFTELS B, C, D). A CONTINUED SURGE IN TOURISM EARNINGS, AN ACCELERATED GROWTH IN EMIGRANT REMITTANCES AND/OR A MAJOR IMPROVEMENT IN THE WORLD ECONOMY COULD EASE THESE CONTRAINTS. SUCH FACTORS, HOWEVER, ARE LARGELY BEYOND THE GOP'S CONTROL. THE GOVERNMENT HAS LITTLE CHOICE BUT TO UTILIZE ITS OWN RESOURCES WISELY AND PROMOTE ENERGETICALLY MORE PRIVATE INVESTMENT, BOTH DOMESTIC AND FOREIGN. SOME OF THE POLICY ACTIONS REQUIRED TO STIMULATE MAJOR NEW INVESTMENTS COULD BE POLITICALLY DIFFICULT TO TAKE, E.G., CHANGES IN LABOR LEGISLATION, IMPLEMENTATION OF COMPENSATION LEGISLATION, A QUICK RESOLUTION OF PENDING INVESTMENT DISPUTES. THEIR ADOPTION MAY WELL DETERMINE, HOWEVER, WHETHER THE COUNTRY ACHIEVES THE DESIRED ECONOMIC RECOVERY AND LONGER-TERM ECONOMIC STABILITY.

B. FOREIGN EXCHANGE SHORTFALLS AND POSSIBLE GOP EFFORTS  
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TO MEET THEM: THE PROSPECT OF A STAGNANT ECONOMY AND DECLINING CONSUMPTION WILL BE EXTREMELY DIFFICULT FOR THE GOP TO ACCEPT, PARTICULARLY AS THE CONGRESSIONAL AND PRESIDENTIAL ELECTIONS OF 1980-81 DRAW NEARER. THE GOVERNMENT IS VERY LIKELY, THEREFORE, TO SEEK A POSITIVE GROWTH RATE OF ABOUT FOUR PERCENT. IF THE GOP ESTABLISHES SUCH A MACRO TARGET, IT WILL IMPLICITLY BE SETTING A CURRENT ACCOUNT BALANCE OF PAYMENTS DEFICIT TARGET OF APPROXIMATELY ONE BILLION DOLLARS. EXCEPTIONALLY EFFECTIVE ACTIONS TO INCREASE TOURIST RECEIPTS, RAISE AGRICULTURE OUTPUT, AND EXPAND EXPORTS MIGHT- HELP TO REDUCE THAT POTENTIAL GAP, BUT IN THE SHORT TERM THEIR IMPACT IS LIKELY TO BE RELATIVELY SMALL. IN FACT, EFFORTS TO RESTRUCTURE THE ECONOMY AND IMPROVE OUTPUT MAY AGGRAVATE RATHER THAN AMELIORATE THE SHORT TERM EXTERNAL DISEQUILIBRIUM. MOST OF THE BENEFITS ARE UNLIKELY TO APPEAR FOR TWO TO THREE YEARS. IN ORDER TO COVER THE SHORT TERM GAP, THE GOP WILL HAVE TO SEEK ADDITIONAL EXTERNAL ASSISTANCE.

PORTUGAL'S FIRST AND FOREMOST PRIORITY MUST BE THE PREPARATION OF A CLEAR STATEMENT OF ITS DEVELOPMENT PLAN AND

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TO SECSTATE WASHDC IMMEDIATE 6316

C O N F I D E N T I A L SECTION 2 OF 3 LISBON 5194

PROCESSES. THIS PLAN SHOULD ESTABLISH RIGOROUS PARAMETERS FOR THE PUBLIC SECTOR AND POSITIVE, CONFIDENCE-BUILDING STIMULI FOR THE PRIVATE SECTOR. A SUCCESSFUL DEFINITION OF THE PROGRAM, FOLLOWED PROMPTLY BY ADOPTION OF THE NECESSARY IMPLEMENTING ACTIONS, WOULD HAVE A VERY BENEFICIAL EFFECT ON PRIVATE SECTOR INVESTMENT INTENTIONS. SINCE MANY OF THESE INVESTMENTS WOULD PRESUMABLY BE FINANCED BY FOREIGNERS OR BY PORTUGUESE DISPOSED TO REPATRIATE THEIR FOREIGN CURRENCY HOLDINGS, SUCH A DEVELOPMENT SHOULD NARROW THE EXTERNAL FINANCING GAP. THE GOP WILL, HOWEVER, STILL HAVE TO SEARCH SPECIFICALLY FOR MORE OFFICIAL AND PRIVATE EXTERNAL CREDITS

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ITS FIRST TASK AFTER PREPARING THE DEVELOPMENT PLAN WILL, THEREFORE, BE THE SUCCESSFUL NEGOTIATION OF AGREEMENT WITH THE IMF FOR AN EXTENDED FINANCING FACILITY PROGRAM AND ACCESS TO THE WITTEVEEN FACILITY. WITH AN IMF AGREEMENT IN HAND, PORTUGAL COULD EXPECT TO RETURN TO THE PRIVATE FINANCIAL MARKETS, SEEK EXTENSIONS ON SOME OF THE CENTRAL BANK'S SHORT-TERM LOANS, AND REQUEST MORE BILATERAL OFFICIAL CREDITS. A COMBINATION OF THE ABOVE FACTORS, AND A FASTER DRAWDOWN OF AVAILABLE PROJECT CREDITS WOULD PROBABLY CLOSE, OR AT LEAST NEARLY CLOSE, THE POTENTIAL FINANCING GAP. THE  
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ABOVE FACILITIES, HOWEVER, ARE UNLIKELY TO BECOME AVAILABLE

IN TIME OR IN SUFFICIENT AMOUNT TO MEET PORTUGAL'S SHORT-TERM NEEDS. THE GOP WILL, THEREFORE, CONTINUE REDUCING ITS GROSS INTERNATIONAL RESERVES. THE GOVERNMENT IS WILLING TO DO SO, BUT IT MUST RETAIN SUFFICIENT FREE RESERVES TO PROTECT ITS CREDIBILITY WITH PRIVATE BANKERS.

C. KINDS OF OUTSIDE ASSISTANCE THAT WILL BE REQUIRED:

THE FOREGOING PARAGRAPHS INDICATE THE TYPE OF FOREIGN ASSISTANCE PORTUGAL WILL REQUIRE. ANOTHER IMF AGREEMENT, A PARTIAL ROLLOVER OF THE CENTRAL BANK'S DEBTS, ADDITIONAL PRIVATE CREDITS, AND AVAILABLE OR PENDING BILATERAL OFFICIAL LOANS WOULD PROBABLY PROVIDE SUFFICIENT LIQUIDITY FOR 1979 AND PART OF 1980. THEY WOULD NOT, HOWEVER, SUFFICE FOR THE LONGER TERM DEVELOPMENT EFFORT. ADDITIONAL RESOURCES WILL BE REQUIRED. SUBSTANTIAL PROJECT AND EXPORT CREDITS, FOR EXAMPLE, WILL CONTINUE TO BE NECESSARY. THUS, THE WORLD BANK SHOULD CONTINUE EXPANDING ITS ACTIVITIES AND THE EC SHOULD APPROVE THE 200 MILLION DOLLAR CREDIT LINE ITS MEMBER PARLIAMENTS NOW HAVE UNDER CONSIDERATION. EXPANDED BILATERAL PROGRAMS WILL ALSO BE ESSENTIAL. THE USG, FOR EXAMPLE, SHOULD MAINTAIN THE PRESENT LEVEL OR INCREASE ITS PL-480 AND CCC PROGRAMS AS WELL AS OFFER A SUBSTANTIAL BILATERAL ASSISTANCE PROGRAM IN FY 1980. TO BE GENUINELY EFFECTIVE, HOWEVER, THESE LENDING PROGRAMS MUST INCLUDE CONSIDERABLE TECHNICAL ASSISTANCE, THEY MUST ENCOMPASS AN EVER LARGER PORTION OF THE PRIVATE SECTOR, AND THE EXPORT PRODUCTS THEY HELP GENERATE MUST HAVE ACCESS TO FOREIGN MARKETS.

D. VALUE OF DIRECTING ASSISTANCE TO SPECIFIC PROJECTS:

EMBASSY CONCURS THAT OFFICIAL DIRECT BALANCE OF PAYMENTS  
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SUPPORT SHOULD HENCEFORTH BE LIMITED BASICALLY TO THE IMF FACILITIES. PROJECT CREDITS UNDOUBTEDLY WILL CONTINUE TO BE IMPORTANT, PARTICULARLY IF PORTUGAL LEARNS TO UTILIZE THEM MORE EFFICIENTLY. FURTHER PROJECT FINANCING COULD HAVE HIGHLY BENEFICIAL EFFECTS IN SUCH AREAS AS AGRICULTURE, FISHING, FOOD PROCESSING AND DISTRIBUTION, TOURISM INFRASTRUCTURE, PORT FACILITIES, SURFACE TRANSPORTATION, PAPER AND PULP INDUSTRY, PUBLIC ADMINISTRATION, AND BUSINESS MANAGEMENT. GIVEN PORTUGAL'S WEAK PUBLIC ADMINISTRATION, THE PRODUCT OF 40 YEARS OF SALAZAR AND FOUR YEARS OF REVOLUTIONARY UPHEAVAL, AND THE LIKELY INCREASED AVAILABILITY OF PROJECT CREDITS FROM THE IBRD AND THE EC, HOWEVER, ONE MUST SERIOUSLY QUESTION THE COUNTRY'S CAPACITY TO ABSORB EVEN MORE SUCH CREDITS PROMPTLY AND EFFECTIVELY ENOUGH TO ALSO SOLVE THE BALANCE OF PAYMENTS GAP. TO AVOID SIMPLY AUGMENTING THE EXISTING PIPELINE, NEW CREDITS SHOULD NOT FOCUS EXCESSIVELY

ON LARGE PUBLIC PROJECTS THAT HAVE LONG GESTATION PERIODS. THEY SHOULD ENCOMPASS VIRTUALLY ANY SOUND PRODUCTIVE ACTIVITY, CONCENTRATE ON SMALL TO MEDIUM UNDERTAKINGS, PLACE SPECIAL EMPHASIS ON THE PRIVATE SECTOR, AND OPEN OPPORTUNITIES TO AMBITIOUS BUSINESSMEN RICH IN INITIATIVE BUT POOR IN FINANCIAL RESOURCES. THIS TYPE OF VARIED PROGRAM COULD HAVE A RAPID, STRONGLY FAVORABLE IMPACT ON THE ECONOMY AS WELL AS ON THE BALANCE OF PAYMENTS.

E. REACTION OF OTHER NATIONS TO PORTUGAL'S ECONOMIC

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FM AMEMBASSY LISBON  
TO SECSTATE WASHDC IMMEDIATE 6317

C O N F I D E N T I A L SECTION 3 OF 3 LISBON 5194

DIFFICULTIES: SEVERAL EUROPEAN NATIONS SEEM SUFFICIENTLY WELL DISPOSED TOWARD PORTUGAL TO ASSIST IT IN A VALID DEVELOPMENT EFFORT. THE SCANDINAVIAN COUNTRIES PRESENTLY OFFER MODERATE BUT SIGNIFICANT AID, AND PROBABLY WOULD INCREASE THEIR ASSISTANCE IF PORTUGAL DEMONSTRATED GREATER ABSORPTIVE CAPACITY. GERMANY, IN ADDITION TO ITS CENTRAL BANK CREDITS AND ITS PARTICIPATION IN THE 750 MILLION DOLLAR LOAN PROGRAM, MAINTAINS AN ACTIVE BILATERAL EFFORT. IT WOULD LIKELY AUGMENT THIS ASSISTANCE SIGNIFICANTLY, PARTICULARLY AS PART OF A EUROPEAN-WIDE RESPONSE TO A REALISTIC PORTUGUESE PROGRAM. RECENT PROPOSALS OF A MINI-MARSHALL PLAN FOR SOUTHERN EUROPE AND DISCUSSION OF FINANCIAL ASSISTANCE FOR THE PROSPECTIVE NEW EC MEMBERS SUGGEST, MOREOVER, THAT THE EC COMMISSION AND GERMANY WOULD BE WILLING TO TAKE THE INITIATIVE IN URGING EUROPEAN NATIONS TO ASSIST PORTUGAL. EVEN FRANCE, WHICH HAS BEEN RELUCTANT TO GRANT UNTIED FINANCING, MAY BECOME MORE RESPONSIVE

TO GOP REQUESTS. GOP OFFICIALS PLAN, IN ANY CASE, TO PRESS  
THE FRENCH DURING THE FORTHCOMING VISIT OF PRESIDENT GISCARD  
D'ESTAING. IN SUMMARY, EMBASSY FEELS THAT THE EUROPEAN  
NATIONS WOULD, AFTER SOME INITIAL HESITATION, AND WITH ENCOURAGEMENT  
FROM THE U.S., RESPOND RATHER FAVORABLY TO A GOP REQUEST  
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FOR ASSISTANCE IN FINANCING A BONA FIDE, RATIONAL DEVELOPMENT  
PROGRAM.  
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## Message Attributes

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